

## REGULATION 1584, MEMBERSHIP FEES

### INITIAL STATEMENT OF REASONS OVERVIEW/NON-CONTROLLING SUMMARY

Regulation 1584 interprets and explains the application of sales and use tax to sales of memberships, as defined. It explains when membership fees must be included in gross receipts and when they are not.

#### **Specific Purpose**

The purpose of the proposed amendments is to interpret, implement, and make specific Revenue and Taxation Code section 6012. These amendments are necessary to provide guidance to that portion of the public which is affected by this statute.

#### **Factual Basis**

Regulation 1584 discusses the application of tax to sales of memberships by retailers. In part, it discusses when the fees for those memberships must be included in the seller's gross receipts.

The Board has previously concluded that when charges for memberships are taxable under Regulation 1584, they remain subject to tax regardless of the party to whom the fees were paid. There is, however, no express language in the regulation that makes the taxability of the membership fees contingent on the memberships being sold by the same entity that makes the related retail sales of tangible personal property. When persons must pay a membership fee exceeding a nominal amount in order to purchase tangible personal property from a retailer or must pay a membership fee to buy tangible personal property from a retailer for a lower price than that paid by nonmembers, that payment of the membership fee is related to the anticipated sale of tangible personal property and subject to tax, regardless of to whom it is paid. Generally, membership fees related to anticipated retail sales of tangible personal property at the retailer's outlet stores or on the Internet are charged by the retailer selling the products. Subsequent to the adoption of the regulation in 1996, at least one entity has restructured its businesses such that the memberships are sold by a separate entity that is affiliated with the retailer of the tangible personal property. The customer must pay the membership fee to obtain the tangible personal property and the membership fee paid to obtain the tangible personal property is subject to tax.

This change in business structure has raised questions as to whether or not the membership fees should be included in the gross receipts of the retailer actually making the sales of tangible personal property or if the membership entity should be issued a seller's permit and report the fees as its own gross receipts. The proposed amendments explain that when sales of the memberships are taxable and the memberships are sold by an entity other than the retailer of the tangible personal property, the gross receipts from the sale of the memberships are part of the consideration for the retailer's sale of tangible personal property, and should be included in the taxable measure of the entity selling tangible personal property. This approach will ensure that the tax on sales of memberships is reported and paid in California when a retailer uses a separate

entity to sell its memberships, whether or not such sales are made by an entity engaged in business in this state. A California retailer selling tangible personal property to members receives the benefit of the membership sales by having members buy tangible personal property at its facilities even if the membership is sold outside the state by an entity not engaged in business in California. By clarifying that the retailer selling tangible personal property to members is responsible to report and pay tax on the gross receipts from the sales of memberships and not the person selling the membership, the potential for retailers seeking to avoid tax on the sale of taxable memberships through the use of out-of-state entities is eliminated.

Pursuant to Government Code section 11346.5(a)(8), the Board of Equalization finds that the adoption of the proposed amendments will not have a significant adverse economic impact on private businesses or persons. The amendments are proposed to interpret, implement, and make specific the authorizing statutes in the context covered by the regulation for greater ease of understanding and to conform the regulation to recent legislation. These changes will clarify the interpretation or administration of the sales and use tax laws. Therefore, the Board has determined that these changes will not have a significant adverse economic impact on private businesses or persons.